

## SECTION 1. PURPOSE

This revenue procedure provides an administrative procedure for existing Blue Cross or Blue Shield organizations, as defined in section 833(c)(2) of the Internal Revenue Code, and certain other organizations described in section 501(m)(1) and (m)(2) to expeditiously obtain the consent of the Commissioner to change their methods of accounting for federal income tax purposes.

## SEC. 2. BACKGROUND

01 Prior to 1987, certain organizations that provided commercial-type insurance were exempt from tax as charitable or social welfare organizations under section 501(c)(3) or (c)(4) of the Code, respectively. Congress was concerned that these organizations were engaged in insurance activities the nature and scope of which were inherently commercial rather than tax exempt.

The Tax Reform Act of 1986 ('Act'), section 1012(a), 1986-3 (Vol. 1) C.B. 307, dealt with these concerns by adding section 501(m) to the Code. Section 501(m)(1) provides that, for taxable years beginning after December 31, 1986, an organization described in section 501(c)(3) or (c)(4) is exempt under section 501(a) only if no substantial part of the organization's activities consists of providing 'commercial-type insurance' as defined in section 501(m)(3) and (m)(4). Thus, for taxable years beginning after December 31, 1986, an organization described in section 501(c)(3) and (c)(4) is not exempt under section 501(a) if a substantial part of the organization's activities consists of providing commercial-type insurance. Under section 501(m)(2), if an organization is described in section 501(c)(3) or (c)(4) and is exempt from tax under section 501(a) after the application of section 501(m)(1) (because no substantial part of its activities consists of providing commercial-type insurance), then the activity of providing commercial-type insurance is treated as an unrelated trade or business, and the organization is treated as an insurance company for purposes of applying subchapter L of chapter 1 with respect to that activity.

02 For taxable years beginning before January 1, 1987, existing Blue Cross or Blue Shield organizations and other organizations described in section 501(m)(1) and (m)(2) of the Code filed returns as tax-exempt organizations on Form 990 (Return of Organization Exempt From Tax Under Section 501(c)). (In some cases, income from the activity of providing commercial-type insurance was reported on Form 990T (Exempt Organization Business Income Tax Return).) In accordance with the instructions for Form 990, these organizations were required to use the same method of accounting on that return that they regularly used to keep their books and records. Generally they used either Generally Accepted Accounting Principles or statutory accounting principles established by the states for this purpose.

Section 1012 of the Act also added section 833 to the Code. Section 833(a)(1)

provides that for taxable years beginning after December 31, 1986, existing Blue Cross or Blue Shield organizations and other organizations described in section 833(c)(3) are taxable as if they were stock property and casualty insurance companies. Property and casualty insurance companies are taxed under provisions of the Code contained in part II of subchapter L of chapter 1. These provisions contain a number of special tax accounting rules.

Because they are subject to the provisions of subchapter L of chapter 1, existing Blue Cross or Blue Shield organizations and the other organizations described in section 501(m)(1) and (m)(2) of the Code may be required to use tax accounting methods different from those used in the past for reporting their insurance activity. For organizations subject to part II of subchapter L, section 832 generally requires the use of an accrual method of accounting with respect to their income and deductions. See Rev. Rul. 77-266, 1977-2 C.B. 236. For any organization described in section 501(m)(1) or (m)(2) whose insurance activities are subject to part I of subchapter L, section 811(a) states that all computations entering into the determination of the taxes imposed by part I shall be made (1) under the accrual method of accounting, or (2) to the extent prescribed by the Secretary, under a combination of an accrual method of accounting with any other method permitted by chapter 1 (other than the cash receipts and disbursements method). To the extent not inconsistent with the preceding sentence or any other provision of part I, all such computations shall be made in a manner consistent with the manner required for purposes of the annual statement approved by the National Association of Insurance Commissioners. In addition, organizations affected by section 501(m) may want to make other changes to existing methods of accounting, even though those changes are unrelated to the Act.

03 Section 446(e) of the Code and section 1.446-1(e) of the Income Tax Regulations state that, except as otherwise provided, in order to change a method of accounting for federal income tax purposes, the taxpayer must obtain the consent of the Commissioner. Section 1.446-1(e)(3)(i) requires that, in order to obtain such consent, generally an application, Form 3115 (Application for Change in Accounting Method), must be filed within 180 days after the beginning of the tax year for which the proposed change is to be made. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to a change in its method of accounting in accordance with section 446(e). These requirements, generally, are applicable to taxable and tax-exempt organizations.

04 Section 481(a) of the Code requires that those adjustments necessary to prevent amounts from being duplicated or omitted be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding tax year.

(1) Section 1012(c)(3)(A)(i) of the Act provides that an existing Blue Cross or Blue Shield organization (as defined in section 833(c)(2) of the Code) shall not make any adjustment under section 481 (or any other provision) on account of a change in its

method of accounting for its first taxable year beginning after December 31, 1986. According to the legislative history, 'such organizations are given a fresh start with respect to changes in accounting methods resulting from the change from tax-exempt to taxable status.' 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-349 (1986), 1986-3 (Vol. 4) C.B. 349.

(2) As is described more fully below, similar treatment regarding the adjustment under section 481(a) of the Code and the regulations thereunder (section 481(a) adjustment) generally applies to other organizations that are described in section 501(m)(1) or (m)(2) and that, for their 1st taxable year beginning before January 1, 1987, treated the provision of commercial-type insurance as other than an unrelated trade or business.

### SEC. 3. SCOPE

This revenue procedure applies to --

(1) existing Blue Cross or Blue Shield organizations (as defined in section 833(c)(2) of the Code),

(2) other organizations that are described in section 501(m)(1), and

(3) organizations described in section 501(m)(2) that, for their last taxable year beginning before January 1, 1987, treated the provision of commercial-type insurance as other than an unrelated trade or business.

For any organization to which this revenue procedure applies, it applies (subject to the limitations stated below) with respect to changes in method of accounting for the taxpayer's first taxable year (year of change) beginning after December 31, 1986. This revenue procedure applies only with respect to a change in the method of accounting or an activity that was treated in the year immediately preceding the year of change as other than an unrelated trade or business. For organizations described in section 501(m)(2) of the Code, this revenue procedure applies only with respect to a change in the method of accounting for the provision of commercial-type insurance.

Taxpayers to which this revenue procedure applies may not use Rev. Proc. 84-74, 1984-2 C.B. 736, for changes with respect to which this revenue procedure applies.

### SEC. 4. APPLICATION

01 In accordance with section 1.446-1(e)(3)(ii) of the regulations, for taxpayers to which this revenue procedure applies and changes with respect to which it applies, the 180-day time period for filing requests to change a method of accounting is extended for the year of change to the earlier of (a) the date the taxpayer files its return for the year of change or (b) the 1st day of the 11th month following the close of the year of change. Under section 1.446-1(e)(2)(i), consent is hereby provisionally granted to an organization

to which this revenue procedure applies to change methods of accounting if this revenue procedure applies with respect to that change. This provisional consent is granted to a taxpayer that files a Form 3115 in the manner described in section 5 of this revenue procedure and that otherwise complies with the provisions of this revenue procedure. The consent becomes final on the date one year from the date the Form 3115 is filed, unless the Service sends notification to the taxpayer on or before that later date.

02 In reviewing the Form 3115, the National Office of the Service will consider all facts and circumstances, including:

(1) whether the method of accounting requested is consistent with the Code, regulations, revenue rulings, revenue procedures, and decisions of the courts;

(2) whether the use of the new method will clearly reflect income; and

(3) whether the taxpayer's books and records will conform with the proposed method of accounting.

03 The Service will notify the taxpayer within one year from the date the Form 3115 is filed if the Service has initial questions concerning whether the taxpayer has adopted a new accounting method that is not a proper accounting method for federal income tax purposes. If a taxpayer complies with the provisions of this revenue procedure and the Service does not send notification to the taxpayer in the one-year period, the taxpayer has obtained the consent of the Commissioner to change its methods of accounting. If in the course of review the Service makes an initial determination that a method of accounting to which the taxpayer desires to change is not acceptable for tax purposes, the taxpayer will be granted the opportunity of a conference in the National Office before the Service makes a final adverse determination.

04 If a taxpayer obtains consent under this revenue procedure to change its method of accounting for a trade or business but the Service determines that the trade or business was an unrelated trade or business in the tax year before the year of change, then (notwithstanding section 5.06 below) the Service may require an appropriate section 481(a) adjustment with respect to that trade or business.

## SEC. 5. MANNER OF EFFECTING THE CHANGE

01 If this revenue procedure applies to a taxpayer and if it applies with respect to a change in method of accounting, then the taxpayer must effect the change by filing a Form 3115 in duplicate. The original shall be attached to the taxpayer's federal income tax return for the year of change, and, at the time the federal income tax return is filed, the duplicate shall be filed with the National Office addressed to the Commissioner of Internal Revenue, Attention: CC:C:2:9, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. If it is found that the taxpayer has not complied with the requirements for the automatic change in method of accounting under this revenue procedure, the National Office or the district director will so advise the taxpayer.

02 In order to assist in the processing of these changes in methods of accounting and to insure proper handling, reference to this revenue procedure shall be made a part of the Form 3115 by either typing or legibly printing the following statement at the top of page 1 of Form 3115: 'FILED UNDER REV. PROC. 87-51.' In the case of a change in the method of accounting for a trade or business that the taxpayer was not conducting on or before August 16, 1986, then, notwithstanding the preceding sentence, the statement to be placed at the top of page 1 of the Form 3115 shall be: 'FILED UNDER REV. PROC. 87-51 -- NEW BUSINESS.'

03 In completing Form 3115, the taxpayer should check the box labeled 'Other (specify)' and insert the following: 'Tax exempt organization (subject to section 501(m)) to taxable insurance company.' The taxpayer should complete the identifying information at the beginning of the form as well as the signature section. The taxpayer need not complete sections other than sections A (Applicable to All Filers Other Than Those Answering 'Yes' to 'Note' Above) and J (Change in Method of Accounting Not Listed Above).

04 In section J of the Form 3115, the taxpayer must also describe the accounting methods to which it is changing and the authority for using those methods. The taxpayer need not describe the methods of accounting from which it is changing.

05 The taxpayer must file its tax return for the year of change on the basis of the methods of accounting to which it proposes to change.

06 If the change in method of accounting is made under the provisions of this revenue procedure, the taxpayer is not required to compute the amount of any section 481(a) adjustment. In the event that the taxpayer subsequently changes a method of accounting from the method adopted under this revenue procedure, the section 481(a) adjustment with respect to any such subsequent change in method of accounting may take into account the fact that the activity being accounted for was not subject to tax prior to the year of change.

07 The signature of the person preparing the request for the change in method of accounting must appear in the space provided for it on the Form 3115. The application must be signed for the taxpayer requesting the change. The individual signing for a corporate taxpayer must be the president, vice president, treasurer, or chief accounting officer (such as the tax officer) who is authorized to sign for the corporation. See the signature requirements set forth in the General Instructions attached to a Form 3115 regarding those who are to sign. If the agent is authorized to represent the taxpayer before the Service, to receive the original or a copy of the correspondence concerning the request, or to perform any other act(s) regarding the application on behalf of the taxpayer, a power of attorney reflecting such authorization(s) must be attached to the application. Taxpayer's representatives without a power of attorney to represent the taxpayer as indicated in this subsection will not be given any information about the application. If the taxpayer is a member of an affiliated group that has elected to file a consolidated federal

income tax return, a Form 3115 submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. (See section 1.1502-77 of the regulations.)

## SEC. 6. EFFECTIVE DATE

This revenue procedure shall be effective October 13, 1987, the date of its publication in the Internal Revenue Bulletin. If a change in method of accounting qualifies under this revenue procedure, any request for permission to make that change must comply with section 5 of this revenue procedure, and all noncomplying requests that are received in the National Office after the effective date will be returned to the taxpayer. A taxpayer that has filed a Form 3115 with the National Office prior to the effective date of this revenue procedure may use the automatic provisions of this revenue procedure and will be notified to this effect by the National Office.

## SEC. 7. CHANGES IN METHOD OF ACCOUNTING TO WHICH THIS REVENUE PROCEDURE DOES NOT APPLY

If an organization described in section 501(m)(1) or (m)(2) of the Code wishes to make a change in method of accounting for the year of change but this revenue procedure does not apply with respect to the desired change, the organization is required to follow Rev. Proc. 84-74. See, however, Announcement 87-89, this Bulletin, which in many cases provides an extension of time for filing the Form 3115 that is required by Rev. Proc. 84-74.

## SEC. 8. INQUIRIES

Inquiries in regard to this revenue procedure should refer to its number and be addressed to the Commissioner of Internal Revenue, Attention: CC:C:2:9, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

## DRAFTING INFORMATION

The principal author of this revenue procedure is Ms. Katherine A. Hossofsky of the Corporation Tax Division. For further information regarding this revenue procedure contact Ms. Hossofsky on (202) 566-4463 (not a toll-free call).